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No. 91-2047

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

NORWEST BANK DULUTH, N.A.,

Petition,

v.

MINNESOTA COMMISSIONER OF REVENUE AND THE STATE OF MINNESOTA,

Respondents.

CAMBRIDGE STATE BANK, *ET AL.*,

Petitioners,

v.

MINNESOTA COMMISSIONER OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Minnesota Supreme Court

BRIEF IN OPPOSITION

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QUESTION PRESENTED

On remand from this Court, the Minnesota Supreme Court decided that it was required under *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), to apply the rule announced in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), retrospectively to the parties in this case. Petitioners sought refunds of bank excise taxes paid on federal obligation income for periods preceding the *Memphis Bank* decision. The court, however, denied petitioners refunds on the basis that: 1) petitioners were estopped under state law to assert the bank tax was invalid because they accepted the benefits of discriminatory exemptions for state bonds; 2) retroactive taxation of state bond interest was not equitable where petitioners themselves, as investors in state bonds, would have borne the burden of such a tax and where federal obligation immunity principles would not be furthered by retroactive taxation; 3) the appropriate remedy was severance of the offending state bond exemptions; and 4) petitioners failed to use a predeprivation procedure in which they could have challenged the tax prior to payment.

The issue presented is whether, under these circumstances, the decision of the Minnesota Supreme Court raises a substantial federal question despite its compliance with the choice of law retroactivity requirements of *Beam* and applicable due process thresholds established in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1990).

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BRIEF IN OPPOSITION

The respondents Minnesota Commissioner of Revenue and State of Minnesota respectfully request that this Court deny the Petition of Writ of Certiorari (hereinafter "Pet.") seeking review of the decision of the Supreme Court of Minnesota in this case. The opinion of the Minnesota Supreme Court is reported at 480 N.W.2d 647 and

is reproduced in the appendix to the petition at page 1A (hereinafter "Pet. App."). This decision was issued on remand from this Court for reconsideration in light of *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). The remand order appears at 111 S.Ct. 2881. The initial decision of the Minnesota Supreme Court is reported at 457 N.W.2d 716. Pet. App. 19A.

STATEMENT OF THE CASE

For more than fifty years Minnesota has had a corporate franchise tax which has included interest income on federal obligations in its net income measure. Minn. Stat. § 290.361 (1978) Pet. App. 71A. The interest on two types of state bonds was, however, excluded from gross income for the purpose of computing the franchise tax. An exemption for revenue bonds issued by the Minnesota State University System (SUBs) for construction of dormitories and other college buildings was enacted in 1957. Minn. Stat. § 136.32 (1978). Pet. App. 74A. An exemption for industrial development bonds (IDBs) was enacted in 1967. Minn. Stat. § 474.12 (Supp. 1979). Pet. App. 75A.[1]

[1] The trial court also found that interest earned on obligations of twelve other state and local agencies was also exempt from inclusion in the bank tax, Pet. App. 25A n.10. This is incorrect. The exemption language pertaining to bonds (other than SUBs and IDBs) was insufficient to exempt them from franchise taxes as opposed to income taxes. Numerous bond counsel opinions to that effect were stipulated to in the case. The Minnesota Supreme Court did not reach the issue whether these other bonds were exempt since respondents conceded the

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During the years in which the two exemptions were in effect prior to their repeal in 1983, neither petitioners nor any other taxpayer challenged the bank tax as discriminatory against U.S. obligations.[2]

In 1983 this Court issued its opinion in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which held a Tennessee bank tax which taxed U.S. obligation interest but exempted interest on over 70 types of state and local obligations to be a discriminatory tax in violation of 31 U.S.C. § 742 ((1959) (now codified as 31 U.S.C. § 3124(a) (1982)). The Minnesota Legislature promptly repealed the IDB and SUB exemptions in 1983, thus removing any conceivable discrimination against federal obligations.

Later in 1983 the petitioner banks and virtually all of the more than 700 banks in the state began filing refund claims for bank taxes as far back as 1979, citing the *Memphis Bank* opinion.[3]

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exempt status of SUBs and IDBs, which was sufficient to present the discrimination issue for the court. See Pet. App. 22A n.8 (n.2 in original opinion misnumbered as n.8 at Pet. App. 2A; *see* 457 N.W.2d at 718 n.2). Only the two exemptions for SUBs and IDBs are referred to in petitioners' appendix. Pet. App. 74A-75A.

[2] Taxes were paid by the petitioners without objection for the 1979-1983 tax years for which they later claimed refunds. As to the 1979 tax year – the "test year" stipulated by the parties for purposes of this action – there was no requirement that taxes be prepaid as a condition of challenging them.

[3] To the extent that petitioners may have foreseen the *Memphis Bank* decision, they of course had a strong incentive not to raise the issue prior to the decision, since they benefitted

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In its initial decision issued on July 20, 1990, the Minnesota Supreme Court found that the bank tax was discriminatory. The court denied refunds, however, on three separate grounds. First, the court held that the banks, being large holders of IDBs, had benefitted from the bank tax exemption for such bonds and were therefore estopped from challenging the exemptions under applicable state case law.

Second, the court ruled that the appropriate remedy under Minnesota law was severance of the offending state bond exemptions. The Minnesota court found that it would, if compelled, actually impose a retroactive tax on state bond interest income. The court declined to impose such a requirement, however, because collection would unfairly penalize both the petitioners, as owners of exempt bonds, and the state for failing to foresee that Minnesota's tax exemptions would be unlawful under Memphis Bank. The court also said that imposing retroactive taxation to level the playing field was not required since the state bond exemptions resulted in no adverse comparative economic impact on petitioners vis-a-vis their competitors.[4] Furthermore, the court noted that in this federal obligation immunity case, actually undoing

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from the state bond exemptions that created the problem. It would have been apparent to anyone contemplating such a challenge that the probable outcome of a decision invalidating the bank tax was the repeal of the offending – and to these taxpayers, desirable – state bond exemptions, rather than a repeal of the tax on federal obligations.

[4] Indeed, all banks who purchased state bonds – including petitioners – received the benefit of tax exempt interest income therefrom.

any damage to the federal borrowing power by state policy during the years in question is impossible.

As a third ground for denying refunds, the Minnesota court found that the *Memphis Bank* case should apply prospectively only. In reaching this conclusion, the Minnesota court applied the three-part prospectivety analysis of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). Under the *Chevron* criteria, the court found that: 1) *Memphis Bank* was not clearly foreshadowed; 2) the purposes of federal tax immunity would not be furthered by retroactive application; and 3) retroactive application of *Memphis Bank* would produce substantially inequitable results.

Petitioners filed a petition for writ of certiorari with the United States Supreme Court requesting review of the Minnesota Supreme Court's decision. While the petitioner was pending, the Court decided *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). The Court then granted the petition, vacated the judgment of the Minnesota Supreme Court, and remanded the case to the Minnesota court for further consideration in light of *Beam*.

On remand, the Minnesota Supreme Court reversed its original holding on prospectivity and held that the *Beam* decision requires retroactive application of the substantive rule of federal law established in *Memphis Bank*. However, the court reaffirmed the independent state law grounds for its earlier decision not to award refunds. The court noted that the *Beam* decision preserves the state's right to raise procedural bars to an otherwise required retroactive application of a federal rule of law. *Beam* also affirmed the state's right to fashion an appropriate remedy where the case originated in state court. The court

found the estoppel holding to be a state procedural bar to recovery of refunds as contemplated under *Beam*. The court also held that minimum constitutional due process requirements were met by the fact that, for the tax years in issue, Minnesota law did not require prepayment of tax in order to challenge the validity of the tax. Thus, there were sufficient procedural safeguards, which petitioners failed to use, against unlawful exaction of the tax at the time it was assessed.

As to the court's remaining severance holding, the court based its denial of refunds on the sufficiency of severance as a remedy for the discrimination caused by the tax. The court noted that when the legislature first enacted the bank tax, there were no state obligation tax exemptions; accordingly, the later exemptions (which caused the defect in the tax) could not be said to have invalidated the entire original act.[5]

In addition, the court again noted that the tax had not placed petitioners at an actual comparative economic disadvantage. Accordingly, neither actual imposition of a corrective tax nor a refund of taxes paid was required.

REASONS FOR DENYING THE PETITION

The decision of the Minnesota Supreme Court on remand is consistent with the principles announced by

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[5] The court noted that under these circumstances, severance was mandated by Minnesota's severance statute, Minn. Stat. § 645.20 (1988). Pet. App. 15A, 29A.

the Court in *Beam* and *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1990). Because federal constitutional thresholds have been met, the remedial inquiry is purely a matter of state law. Therefore, no substantial federal question is raised by the petition.

The decision on remand of the Minnesota Supreme Court complied with the *Beam* requirement of retroactive application for choice of law purposes of the substantive rule of federal law established in *Memphis Bank*. Thus this case presents no retroactivity issue, unlike *Harper v. Virginia Dept. of Taxation*, 410 S.E.2d 629 (Va. 1991), *cert. granted*, 60 U.S.L.W. 3779 (1992). Moreover, any due process issues which might otherwise be raised by the denial of refunds are obviated by the availability of a predeprivation right to challenge payment of the tax under Minnesota law for the years at issue. Petitioners' failure to avail themselves of these predeprivation procedures does not entitle them now to challenge the denial of refunds on federal constitutional grounds.

Given the lack of any due process infirmity in light of the availability of a predeprivation remedy, the estoppel and severance grounds for the Minnesota Supreme Court's decision are independent and adequate state law grounds for the decision which should not be reviewed by this court.

I. THE MINNESOTA SUPREME COURT'S DENIAL OF REFUNDS RAISES NO SUBSTANTIAL FEDERAL QUESTION AND WAS CONSISTENT WITH *MCKESSON* WHERE PETITIONERS HAD A FULLY ADEQUATE PREDEPRIVATION REMEDY, WHERE PETITIONERS THEMSELVES WOULD HAVE BORNE THE BRUNT OF A RETROACTIVE EQUALIZING TAX, AND WHERE PETITIONERS SUFFERED NO COMPETITIVE HARM OR COMPARATIVE ECONOMIC DISADVANTAGE AS A RESULT OF THE STATE BOND EXEMPTIONS.

Contrary to petitioner's assertions, this case does not raise significant constitutional issues. Those issues raised by the Minnesota Supreme Court's initial prospectivity ruling under *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) were resolved in favor of petitioners on remand. Any federal issues left unresolved by *McKesson* and *Beam* in connection with intergovernmental immunity cases are more fruitfully addressed in a case such as *Harper v. Virginia Dept. of Taxation*, 401 S.E.2d 868 (Va. 1991), *vacated*, 111 S.Ct. 2883 (1991), *on remand*, 410 S.E.2d 629 (Va. 1991), *cert. granted*, 60 U.S.L.W. 3770 (1992), in which the state court held that it was not obligated retroactively to apply the rule announced in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989).

In *McKesson*, the Court indicated the circumstances in which a state must provide refunds to a taxpayer burdened by a discriminatory tax which violates the Commerce Clause. *McKesson* held that where there is no adequate predeprivation remedy, a state must, in a postdeprivation proceeding, offer a "clear and certain remedy," for any erroneous or unlawful tax collection to

ensure that the opportunity to contest the tax is a meaningful one. Refunds may be constitutionally required in a postpayment proceeding where no other remedy is adequate, as is the case where the taxpayer is absolutely immune from the tax, or where the tax is beyond the power of the state to impose (for reasons other than its discriminatory nature).

A refund may also be required under *McKesson* where the state does not (or cannot) impose a curative tax by assessing and collecting back taxes from a taxpayer's competitors who benefitted from lower taxes in a discriminatory tax scheme. A retroactive curative tax, or refunds in lieu thereof, are particularly likely to be required in a Commerce Clause case like *McKesson*, where the state used its tax laws to further policies of economic protectionism which offend the Commerce Clause, with the result that one class of taxpayers was singled out for favorable tax treatment to their competitors' disadvantage.

Nothing in *McKesson* suggested that its reasoning was limited to application in Commerce Clause cases, however. Citing *Montana National Bank of Billings v. Yellowstone County*, 276 U.S. 499 (1928), the Court in *McKesson* suggested that the same principles should apply in any case involving discriminatory taxation under federal law.

Thus, the Minnesota Supreme Court correctly assumed, in its opinion on remand, that *McKesson* provided the "possible constitutional thresholds" referred to in *Beam* as limiting the state law remedial inquiry. Pet. App. 14A. The Minnesota Supreme Court distinguished

McKesson, however, on the basis that Minnesota unlike Florida did not require prepayment of taxes prior to challenging them, but instead offered a fully adequate predeprivation opportunity to be heard. It is this crucial difference which most clearly distinguishes this case from *McKesson* and *Beam* and is the most compelling reason to deny the petition.

A. *McKesson* is Not Applicable Because Minnesota Provided Predeprivation Relief.

In *McKesson*, the Court explained:

> *[I]f a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he can challenge the tax's legality,* the Due Process Clause of the Fourteenth Amendment obligates the state to provide meaningful backward-looking relief to rectify any unconstitutional deprivation.

McKesson, 496 U.S. at 31 (emphasis added) (footnote omitted). Relief may be either through additional tax assessments against those benefitting from the discriminatory tax or through refunds to the disfavored taxpayers, or some combination of the two.

But, as the Court stated:

> In contrast, if a state chooses not to secure payments under duress and instead offers a meaningful opportunity for taxpayers to withhold contested tax assessments and to challenge their validity in a predeprivation hearing, payments tendered may be deemed "voluntary." *The availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process*

> *Clause, and taxpayers cannot complain if they fail to avail themselves of this procedure.*

McKesson, 496 U.S. at 38 n. 21 (emphasis added) (citations omitted).

In this case the Minnesota Supreme Court held that during the tax years at issue, Minnesota law allowed an appeal to its tax court *without* prepayment. The court stated, "more important, however, is the fact that, in each year at issue, the banks *could have* avoided paying the tax before challenging its constitutionality. Thus, there were sufficient procedural safeguards against unlawful exactions of the tax *at the time* it was *assessed*." Pet. App. 10A (emphasis in original).

While petitioners characterize this holding as "unprecedented," it is entirely consistent with the Minnesota statutes and cases dealing with tax court jurisdiction.[6] The Minnesota Tax Court has broad authority to decide disputes involving the tax laws of Minnesota.[7] For

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[6] Petitioners claim that in this case the Minnesota Supreme Court held for the first time that relief should be denied because petitioners could have litigated in the Tax Court. Pet. 17. This is incorrect. The court simply held, consistent with *McKesson*, that refunds could *constitutionally* be denied because of the existence of a predeprivation remedy. The substantive grounds for denial of the refunds are the acceptance of benefits estoppel doctrine and severance grounds.

[7] Minn. Stat. § 271.01, Subd. 5 (1980) provides in relevant part: "The tax court shall have statewide jurisdiction. Except for an appeal to the supreme court or any other appeal allowed under this subdivision, the tax court shall be the sole, exclusive, and final authority for the hearing and determination of *all questions of law and fact* arising under the tax laws of the state, as defined in this subdivision, in those cases that have been appealed to the tax court and in any case that has been transferred by the district court to the tax court." (Emphasis added.)

the 1979-80 tax years, Minnesota law did not require prepayment in order to challenge the validity of a tax. Minn. Stat. § 271.09, subd. 3 (1978) provided that "at the time of taking an appeal to the tax court, the taxpayer shall pay at least the amount of the tax or other obligation *conceded by the taxpayer to be due, if any,* when it becomes due. . . . " (Emphasis added.) Petitioners concede this to be the case. Pet. 15-16. They claim, however that Minnesota "case law" in 1980 indicated that the only procedure available to challenge the constitutionality of a tax was the refund procedure followed by petitioners in this case.[8] Pet. 18. Here too, petitioners are mistaken.

As the Minnesota Supreme Court expressly reaffirmed in its opinion in this case, prior to 1980, the tax court had subject matter jurisdiction over constitutional challenges to taxes assessed. Pet. App. 9A.[9] In September,

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[8] Petitioners also imply that they are entitled to refunds simply because they fully complied with the procedural requirements of the refund statute, Minn. Stat. § 290.50 (1982 & Supp. 1983). However, nothing in that statute requires the court to award refunds in particular cases, precludes the commissioner from raising procedural bars or equitable defenses to the claim, or establishes substantive principles of law for the determination of cases. The statute merely authorizes refund claims and establishes procedures for their resolution, and is silent as to the circumstances in which such claims may be granted or denied. It does not follow that Minnesota is constitutionally required to award refunds simply because it has a statutory framework for making claims. The cases cited by the petitioners in which taxpayers were awarded refunds are therefore irrelevant. *See also infra* note 15.

[9] The Minnesota Supreme Court's determination as to the procedures available under state law for the test year of 1979 is

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1980, in *In re McCannel*, 301 N.W.3d 910, 920 (Minn. 1980), the Minnesota Supreme Court held that the tax court, as part of the executive branch, had only such authority to hear and decide constitutional issues as was conferred on it by the state's district courts. In subsequent decisions, however, the court made it clear that it would continue to consider constitutional issues raised in tax court cases filed prior to the date of the *McCannel* decision. *Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138, 139 n.1 (Minn. 1980); *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261, 264 (Minn. 1984).

Moreover, even after *McCannel*, parties continued to be able to raise constitutional questions in prepayment tax court proceedings by the simple expedient of filing the tax court appeal and moving the tax court for transfer of constitutional issues to state district court. The district court could then either retain those issues for decision or transfer them back to tax court complete with constitutional jurisdiction. *See, e.g. Nagaraja v. Commissioner of Revenue*, 352 N.W.2d 373 (Minn. 1984). (transfer procedure used in 1982 to confer constitutional jurisdiction on tax court in appeal filed in 1981). This procedure was

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presumably final, and should not be disturbed by this Court. *See American Trucking Ass'ns, Inc. v. Smith*, 496 U.S. 167, 177 (1990) (comity requires the Court carefully to disentangle issues of federal law from those of state law and to refrain from deciding anything apart from questions of federal law directly presented).

described and formally sanctioned by the Supreme Court in *Erie Mining*.[10]

Thus, for the test year selected by the parties, 1979, Minnesota law clearly allowed an appeal to its tax court *without* prepayment.[11] Minnesota therefore did provide for meaningful predeprivation relief and the threshold requirement for retroactive relief of any sort cannot be established by petitioners under *McKesson*. The petition should be denied on this basis alone.

B. *McKesson* Does Not Require A State To Provide Relief in the Form of Refunds In Intergovernmental Immunity Cases Where Refunds Would Not Further The Principles Of Federal Obligation Tax Immunity.

Petitioners argue that this Court should nevertheless grant certiorari to hold that *McKesson* requires refunds in Supremacy Clause cases (apparently regardless whether predeprivation relief is available) for three reasons. First,

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[10] As demonstrated by the *Nagaraja* case, other parties had no trouble figuring out how to litigate constitutional issues in tax court well before *Erie Mining*, despite petitioners' assertion that prescience was required. Pet. 19 n.11.

[11] No prepayment requirement was enacted until the 1981 tax year. Even when there was a prepayment requirement (since repealed), a taxpayer could avoid prepayment by showing that the appeal was in good faith, that there was probable cause that the taxpayer would be found exempt from the tax or that the tax ultimately determined might be less than fifty percent of that assessed and that prepayment would work a substantial hardship. Minn. Stat. § 290.531 (1982).

petitioners argue that the Minnesota bank excise tax was "beyond the state's power to impose" and that under *McKesson*, "[s]ince there is no way to 'cure the invalidity of the tax,' the tax must be refunded." Pet. 12. Second, petitioners claim that "[t]he Minnesota Supreme Court's decision, if not reversed, would effectively end private enforcement of immunity doctrine rights." Pet. 13. Finally, petitioners claim that the Minnesota Supreme Court's decision conflicts with a recent decision of the Ninth Circuit Court of Appeals, *United States v. City of Spokane*, 918 F.2d 84 (1990), *cert. denied*, 111 S.Ct. 2888 (1991) Each of these asserted reasons for granting the petitioner is spurious.

First, the Minnesota bank excise tax is not "beyond the state's power to impose" nor are petitioners "absolutely immune from the tax." Applicable federal law expressly authorizes nondiscriminatory corporate franchise taxes which include interest on federal obligations in the computation of the tax. 31 U.S.C. § 742 (1959) (now codified at 31 U.S.C. § 3124 (a) (1982)). The Minnesota bank excise tax was concededly valid, but for the offending exemptions for IDBs and SUBs.

Nothing in *McKesson* suggests that different principles apply to discriminatory taxes challenged under the Supremacy Clause rather than the Commerce Clause. In fact, the contrary conclusion is suggested by *Montana National Bank of Billings v. Yellowstone County*, 276 U.S. 499 (1928), discussed in *McKesson*, 496 U.S. at 34-35, where this Court stated, "we applied the same due process analysis to a tax that was unlawful because it was *discriminatory*, though otherwise within the state's power to

impose." (Emphasis in original). Instead, the Court suggested in the following language that certain cases might require refunds for other reasons:

> Had the Florida courts declared the liquor tax invalid either because (other than its discriminatory nature) it was beyond the state's power to impose, as was the unapportioned tax in *O'Connor*, or because the taxpayers were absolutely immune from the tax, as were the Indian tribes in *Ward* and *Carpenter*, no corrective action by the state could cure the invalidity of the tax during the contested period. The state would have had no choice but to "undo" the unlawful deprivation by refunding the tax previously paid under duress, because allowing the state to "collect these unlawful taxes by coercive means and not incur any obligation to pay them back . . . would be in contravention of the Fourteenth Amendment." (Citations omitted).

McKesson, 496 U.S. at 39.

What distinguishes this case from *McKesson* and *Montana National Bank* is not, as petitioners argue, the clause of the Constitution under which the tax is attacked, but the factors cited in the Minnesota Supreme Court's opinion. First, Minnesota offered meaningful prepayment relief, unlike Florida in *McKesson* or Montana in *Montana National Bank*. Second, rather than being victims of a discriminatory tax, petitioners personally benefitted from the very tax exemptions which created the discriminatory effect. Finally, a retroactive "curative" tax would have primarily fallen on the very taxpayers challenging the validity of the discriminatory tax scheme.[12] It is these

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[12] Ironically, as heavy investors in IDBs, petitioners are economically better off under the remedy actually chosen in

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factors which supported the Minnesota Supreme Court's decision as to the appropriate remedy in this case, and not any purported distinction between Commerce Clause and Supremacy Clause jurisprudence.

Petitioners also raise the spectre of an end to private enforcement of intergovernmental immunity doctrine rights. This is nonsense. As acknowledged in *McKesson*, there can be no chilling effect from a denial of refunds in a postdeprivation proceeding where a state also offers a prepayment remedy. Second, the federal government is not helpless to defend its own interests under the Supremacy Clause generally and under 31 U.S.C. § 742 specifically.[13] It has often commenced suits to declare state taxes unconstitutional.[14]

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this case, severance of the offending state exemptions, than they would have been had the court imposed a curative tax on the exempt bonds, a remedy which clearly passes constitutional muster under *McKesson*.

[13] While petitioners acknowledge that it is possible that the federal government could sue to prevent discrimination, they claim they have not been able to find a single case under section 742 in which the federal government has done so. Pet. 13. That fact alone indicates that there is no shortage of private plaintiffs prepared to attack discriminatory taxes. Moreover, on the very next page of the petition, the banks cite an intergovernmental immunity case involving the United States as plaintiff. *United States v. City of Spokane*, 918 F.2d 84 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991). Pet. 14.

[14] *See, e.g., United States v. County of Fresno*, 429 U.S. 452 (1977) (government challenged tax on government-owned housing used by private citizens); *United States v. New Mexico*, 455 U.S. 720 (1982) (government challenged a sales/use tax on goods and services purchased by private contractors under contracts with U.S. to manage government-owned laboratories).

This case also presents a relatively rare combination of facts which are not likely to be duplicated. Few cases will involve taxpayers who do not object to a discriminatory tax scheme for 25 or more years, who benefit from the very discrimination complained of, and who fail to utilize prepayment challenge procedures. The denial of a refund remedy in this case hardly means that state governments "will be able to impose discriminatory taxes with impunity." Pet. 13.

This case is squarely within the parameters of *McKesson* due process requirements, and in no way expands the area in which states may constitutionally deny tax refunds. The narrow impact of this case is demonstrated by another recent decision under 31 U.S.C. § 3124(a) cited by petitioners, in which the Minnesota Supreme Court affirmed the award of refunds to taxpayers (who, unlike the banks, had not benefitted from discriminatory tax exemptions). *Yurista v. Commissioner of Revenue*, 460 N.W.2d 24 (Minn. 1990).[15]

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[15] Although *Yurista* involved refunds, other Minnesota tax cases have resulted in other types of remedies. For example, in *Johnson Brothers Wholesale Liquor Co. v. Commissioner of Revenue*, 402 N.W.2d 791 (Minn. 1987), the court severed a statutory provision imposing lower liquor tax rates on locally produced wine and retroactively imposed a compensating tax on the favored wine producers, thus correcting discriminatory taxes which were found to violate the Commerce Clause under *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984). In light of the severance remedy, the court held that the plaintiff in *Johnson Brothers* was not entitled to refunds.

Petitioners also endeavor to manufacture a conflict between the decision in this case and the *City of Spokane* decision. In that case the Ninth Circuit Court of Appeals struck down a tax imposed by the city on the American Red Cross, which the court held to be an instrumentality of the United States. Given that the state had no power to exact a tax from a federal instrumentality (whether or not the tax was discriminatory), the court ordered the improperly taken tax monies refunded as "the only logical relief." 918 F.2d at 89. The *City of Spokane* court did not hold, as petitioners assert, that a tax that violates the intergovernmental immunity doctrine must in all cases be refunded. Rather, it held, consistent with *McKesson*, that a tax collected from an entity *absolutely immune* from state taxation must be refunded.

There is a world of difference between the type of tax in *City of Spokane* and the bank excise tax here, which, but for the two state bond exemptions, was clearly within the state's power to impose. Petitioners are neither absolutely immune from taxation, nor is the bank excise tax (other than for its discriminatory nature) beyond the state's power to impose. The supposed conflict between *City of Spokane* and this case is thus wholly illusory. Because this decision presents no conflict either with *McKesson* or the intergovernmental immunity cases, the petition should be denied.

II. THE STATE LAW ESTOPPEL GROUND FOR THE MINNESOTA SUPREME COURT'S DECISION IN THIS CASE DOES NOT RAISE A SUBSTANTIAL FEDERAL QUESTION.

On remand, the Minnesota Supreme Court also reaffirmed its original holding that, under a well established line of Minnesota cases, the banks were estopped from asserting the unconstitutionality of the Minnesota bank tax.

Petitioners urge the Court to review the estoppel holding because it allegedly does not have a "fair or substantial basis." Pet. 22-24. They also assert that the estoppel holding means that "as a precondition to challenging a discriminatory tax on federal obligations, petitioners would have had to pay an alternative form of discriminatory tax on state obligations." Pet. 22. Petitioners' argument is based on a gross mischaracterization of the state court's ruling. Moreover, it fails to raise a substantial federal question in light of the Minnesota court's holdings in this case as to retroactivity and predeprivation remedies.

Petitioners apparently argue that the Minnesota Supreme Court estopped petitioners' recovery of refunds because they failed to pay a judicially imposed tax.[16]

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[16] In making this argument petitioners again ignore the fact that payment of a tax was not a prerequisite for challenging its validity for the time period at issue. Petitioners do not argue, and the Minnesota Supreme Court did not hold, that petitioners would have been estopped to raise the constitutional issue in a prepayment challenge to an assessment by the commissioner.

Nothing in either opinion of the Minnesota Supreme Court suggests this rationale. Instead, the court expressly held that it was petitioners' enjoyment of the tax benefit of the challenged exemption that gives rise to estoppel. Pet. App. 11A-12A, 27A.

A. Estoppel Is A Well-Recognized Principle Under Both State And Federal Law.

That certain taxpayers may be estopped from raising claims challenging the validity of tax schemes is a well recognized principle under both state and federal law. Minnesota has long recognized an acceptance of benefits doctrine in tax cases, under which a taxpayer is estopped from assuming the validity of a statute for the purpose of receiving its benefits while also attacking it as unconstitutional in an attempt to receive even greater rewards. *See Gale v. Commissioner of Taxation*, 37 N.W.2d 711 (1949) (taxpayer who claims tax reduction as result of statutory amendment estopped from challenging effective date of amendment). The estoppel doctrine of "acceptance of benefits" has also been applied in federal cases,[17] as in,

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[17] When applied in federal tax cases the acceptance of benefits doctrine is variously known as the "duty of consistency" or "quasi-estoppel." Under this doctrine, a taxpayer who has received a tax benefit due to treatment of an item in a year barred by the statute of limitations as to an additional assessment is precluded from claiming that the original treatment was incorrect in order to obtain a tax advantage in a later year. *See Beltzer v. United States*, 495 F.2d 211, 212 (8th Cir. 1974); *Unvert v. Commissioner*, 72 T.C. 807 (1979), *aff'd on other grounds* 656 F.2d 483 (9th Cir. 1981); *Griffith v. Commissioner*, T.C.M. (P-H) ¶89,070 (1989); *Coldiron v. Commissioner*, T.C.M. (P-H) ¶87,569 (1987).

for example, *Arnett v. Kennedy*, 416 U.S. 134, 152-53 (1974) (plurality opinion) (Court viewed skeptically action of litigant in challenging constitutionality of portions of federal civil service statutes under which he simultaneously claimed benefits); *Magee v. United States*, 282 U.S. 432 (1931) (taxpayer who benefitted from claim in abatement not in position to challenge its legality); and *Strickland v. Flue-Cured Tobacco Coop. Stabilization Corp.*, 643 F. Supp. 310 (D.S.C. 1986) (rebate beneficiaries of federal tobacco price support program barred under doctrine of constitutional estoppel from attacking the statute authorizing rebates). The Court has also applied estoppel as a matter of federal common law, in order to preserve significant policy interests and prevent unjust results. *D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation*, 315 U.S. 447 (1942) (maker of note estopped to assert lack of consideration as defense to suit on note brought by FDIC as insurer of lending bank).

Likewise, under the federal doctrine of constitutional estoppel, this Court has refused to allow litigants to challenge statutes under which they have voluntarily accepted benefits. In *Fahey v. Mallonee*, 332 U.S. 245 (1947), the Court held that "[i]t is an elementary rule of constitutional law that one may not retain the benefits of the act while attacking the constitutionality of its important conditions," and that "[t]he court will not pass upon the constitutionality of a statute at the instance of one who has availed himself of its benefits." *Id.* at 255 (citations omitted). *See also Federal Deposit Insurance Corporation v. American Bank Trust Shares, Inc.*, 460 F. Supp. 549, 556-57 (D.S.C. 1978) (finding that *Fahey* has not been modified or overruled and holding plaintiffs estopped

from contesting constitutionality of statutes), *aff'd on other grounds*, 629 F.2d 951 (4th Cir. 1980).

Moreover, equitable considerations have long been recognized as appropriate to the determination of a remedy in tax refund actions. In *Stone v. White*, 301 U.S. 532 (1937), the Court held that an "action, brought to recover a tax erroneously paid, although an action at law, is equitable in its function." 301 U.S. at 534. The Court stated:

> Since, in this type of action, the plaintiff must recover by virtue of a right measured by equitable standards, it follows that it is open to the defendant to show any state of facts which, according to those standards, would deny the right. . . .

Id. 535 (citations omitted). Thus, use of estoppel doctrines to deny refunds in tax cases is not a revolutionary idea at either the state or federal level.

Petitioners claim, however, that estoppel should not apply to them since 1) they did not challenge the state obligations exemptions, the benefit of which they received, and 2) the benefit of the exemptions was "wholly illusory" because the interest rates on exempt state obligations "were lower than they would otherwise have been if the obligations had been taxable." Pet. 23. Neither argument is well taken.[18]

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[18] Petitioners also make the puzzling assertion that if the estoppel doctrine were a valid basis for denying tax refunds, then the taxpayers in *Memphis Bank* and *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935) should have been estopped. It

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First, had it not been for the state bond exemptions, there would have been absolutely no basis for petitioners' complaints. To challenge the Minnesota bank excise tax as discriminatory, they were forced to assert the exemptions were unlawful. As a franchise tax, Minnesota's bank excise tax may lawfully include U.S. obligation income in its measure, consistent with 31 U.S.C. § 3124(a) (1982). Inclusion of U.S. obligation income in the Minnesota tax did not make the tax unlawful. As the Minnesota court held: "It is the exemption for interest earned on state obligations that makes the bank tax discriminatory and, therefore, unconstitutional." Pet. App. 28A. Petitioners' claim that they did not really challenge the exemptions for state obligations which created the discriminatory effect is therefore disingenuous and was rightly rejected by the Minnesota court.[19]

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is not clear why petitioners believe that litigants in Tennessee and Pennsylvania should have achieved the same results under the laws of their states, which may differ on such matters as estoppel, laches and statutes of limitations. In any event, there is no indication that the parties in those cases raised an estoppel issue, even if the doctrine was recognized in their states.

[19] *Kadrmas v. Dickinson Public Schools*, 487 U.S. 450 (1988), cited by petitioners, is inapposite since it does not involve a tax benefit which was part and parcel of the tax whose constitutionality was being attacked. In *Kadrmas*, the court noted that plaintiffs were actually *burdened* (they were required to pay a school bus transportation fee) rather than *benefitted* by the statute they challenged, and were therefore not estopped by their supposed "enjoyment" of the bus transportation. Likewise, *Nash v. Florida Industrial Commission*, 389 U.S. 235 (1967), is inapposite, since the issue there was not estoppel, but whether a state can refuse to pay unemployment insurance to persons solely because they have brought federal unfair labor practice charges against their employer.

Second, petitioners assert that they did not really benefit from the state bond exemptions because interest rates on exempt state obligations were lower than they otherwise would have been if the obligations had been taxable.[20] Petitioners' argument requires the Court to accept implicit assumptions not supported by the trial record. The Court is asked to assume that there was a dollar reduction in interest earned for each dollar of tax exemption received; that tax exemptions for bonds are of no net benefit to bond holders; that the entire benefit of tax exemption for tax-exempt bond issues goes to the bond issuers rather than to bond holders; and that apparently the banks invested in state bonds contrary to their own economic interest. If these assumptions are true, one wonders why investors did not flee from IDBs and SUBs in droves, thereby improving rather than damaging the federal borrowing power.

In any event, it is clear that petitioners took advantage of the very exemptions for state obligations which created the discriminatory impact on federal obligations. Whether they made or lost money on their investment in state obligations is beside the point. They clearly accepted a *tax benefit* from the state bond exemptions.[21] It

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[20] Contrary to petitioners claim that the Minnesota court "conceded that the economic benefit to petitioners was 'wholly illusory'," Pet. 23, the court merely noted that the trial court's findings supported the claim that interest paid on exempt state obligations was lower than it would have been without the exemption. Pet. App. 11A.

[21] As the Minnesota Supreme Court observed, "Respondents do not dispute that they accepted the tax benefits of the exemption for interest on State of Minnesota obligations." Pet. App. 27A.

is the petitioners' acceptance of the tax benefit, and not the profitability of their investment, that gives rise to estoppel.

Thus, the Minnesota decision does not establish a new principle fatal to refund actions challenging unconstitutional taxes. The decision merely applies well-established equitable doctrines to the facts in this case. While other taxpayers who did not own exempt state obligations may challenge the tax as discriminatory these petitioners may not. The decision affects only litigants like petitioners who want to have their cake and eat it too.

B. *Beam* Does Not Preclude Consideration Of Individual Equities in Particular Cases.

The application of equitable interests in state tax cases was expressly reserved to the courts in *Beam*, which acknowledged that the question of an appropriate remedy is governed by state law, subject only to possible constitutional thresholds:

> [N]othing we say here precludes consideration of individual equities when deciding remedial issues in particular cases.
>
> . . .
>
> *Nor do we speculate about the remedy that may be appropriate in this case;* remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by reference to our decision last Term in *McKesson*. As we have observed repeatedly, federal "issues of remedy . . . may well be intertwined with, or their consideration obviated by issues of state law." *Nothing we say here*

> *deprives respondent of his opportunity to* raise procedural bars to recovery under state law or *demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which McKesson did not deal.*

Beam, 111 S. Ct. at 2448 (emphasis added) (citations omitted).

Neither the acceptance of benefits doctrine nor any similar estoppel doctrine was at issue in *Beam*. Retroactivity as a remedial principle (rather than as a choice of law principle) clearly recognizes the equitable and reliance interests of the parties. Nothing in either *McKesson* or *Beam* should be seen therefore as inconsistent with application of such traditional equitable doctrines in tax cases.

The justice in applying an estoppel to these petitioners' claims of discrimination is plain. Petitioners are the type of taxpayer who should be properly estopped from asserting that a tax is discriminatory. All four of the test banks (petitioners) were holders of IDBs. All four reduced their Minnesota bank taxes by claiming the IDB interest as exempt income. They so stipulated.

Respondents were properly estopped from challenging the exemptions which caused the discriminatory effect of which they complained. They had benefitted from those very exemptions for over twenty-five years. They used the exemptions to reduce their tax liabilities for the years for which they now seek refunds. As the Minnesota Court noted, granting the banks millions of dollars in refunds[22] now would provide them an

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[22] At trial respondents presented evidence that approximately $122 million in tax and another $66 million in interest (through March 31, 1990) was claimed by petitioners and all

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undeserved windfall by allowing them to have operated essentially tax-free during the periods in question while they silently reaped the benefits of the discriminatory state bond exemptions. Pet. App. 33A.

Application of state law estoppel principles to bar claims in appropriate cases is unaffected by *Beam*, which recognized that states have options and flexibility in fashioning remedies. The Minnesota court responsibly exercised its judgment to fashion an appropriate remedy in this case. *Beam* recognized that in cases originating in state court, state law procedural and remedial issues do not ordinarily raise substantial federal issues. Particularly here, where petitioners could have challenged the tax in a prepayment proceeding, no federal issue justifying further review has been raised.

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other Minnesota banks which have filed refund claims. The trial court found this amount to be "speculative," Pet. App. 60A-61A. The Minnesota Supreme Court did not address this issue, merely observing that "Respondents have not explained how the borrowing power of the United States will be protected by allowing them to receive multimillion dollar refunds." Pet. App. 32A.

CONCLUSION

For the foregoing reasons the petition should be denied.

Respectfully submitted,

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